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In the Supreme Court of the United States

OCTOBER TERM, 1982

LOUISIANA PUBLIC SERVICE COMMISSION, PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION IN OPPOSITION

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QUESTION PRESENTED

Whether the Federal Energy Regulatory Commission properly allowed existing automatic adjustment clauses in a public utility rate tariff, involving sales among affiliated companies, to be expanded when such clauses reflect actual increases and decreases in costs incurred by the utility.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases:

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A-21 to A-33) is reported at 688 F.2d 357. The decision and order of the Federal Energy Regulatory Commission (Pet. App. A-2 to A-20) are reported at 16 F.E.R.C. (CCH) ¶ 61,101, *sub nom. Middle South Services, Inc.* The decision and order of the administrative law judge are reported at 13 F.E.R.C. (CCH) ¶ 63,032 (Nov. 13, 1980).

JURISDICTION

The judgment of the court of appeals was entered on October 4, 1982. The petition for a writ of certiorari was filed on December 30, 1982. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1) and Section 313(b) of the Federal Power Act, 16 U.S.C. 825*l*(b).

STATUTE INVOLVED

Sections 205(d) and 205(f) of the Federal Power Act, 16 U.S.C. (Supp. V) 824d(d) and 824d(f), are set forth at Pet. App. A-34 to A-36. Section 205(e) and Section 206 of the Act, 16 U.S.C. 824d(e) and 824e, are set forth in an appendix to this brief, *infra*, 1a-2a.

STATEMENT

1. Middle South Utilities, Inc., is a public utility holding company with four electric utility operating subsidiaries that sell electricity at wholesale and at retail in Mississippi, Arkansas, Missouri and Louisiana. Middle South also has a service subsidiary, Middle South Services, Inc., that acts as an agent for the operating subsidiaries (Pet. App. A-3 to A-4). Since 1973, the operating subsidiaries have operated under an interconnection agreement, known as the System Agreement, which provides, *inter alia*, for the coordinated exchange (pooling) of power and energy among members of the Middle South System. Since the System Agreement is a wholesale rate schedule, it must be filed with the Commission pursuant to Section 205 of the Federal Power Act, 16 U.S.C. (& Supp. V) 824d.[1] The original System

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[1] Section 205(c) of the Act, 16 U.S.C. 824d(c), provides that every public utility shall file with the Commission its rate schedules for any transmission or sale subject to the Commission's jurisdiction. Under Section 205(d), 16 U.S.C. (Supp. V) 824d(d), utilities must also file with the Commission any proposed changes in its rate schedules at least 60 days before the effective date of such changes; the Commission may, on a showing of good cause, waive the 60-day notice requirement. Section 205(e), 16 U.S.C. 824d(e), provides that the Commission may suspend any new schedule for a period of up to five months and may investigate the lawfulness of such new rates. If the Commission's investigation is not completed within the five month period, the utility may collect the new rates, subject to refund, if the Commission ultimately determines that the rates are unlawful in whole or in part.

Agreement was filed with the Commission in 1973, and an amendment to that agreement was filed in 1979 as a rate change under Section 205 of the Federal Power Act. Middle South Services, Inc., acting as agent for the operating companies, submitted the amendment for filing (Pet. App. A-3). Under the 1973 Agreement, several categories of expenses were subject to "automatic adjustment clauses."[2] The 1979 amendment expanded the coverage of the automatic adjustment clauses to include all items of cost except the rate of return on equity, which was fixed and was not subject to change without the filing by the utility of new rates (*id.* at A-6).[3]

2. The Commission accepted the amendment for filing but suspended its effectiveness until June 1, 1979. At that time the amendment became effective, subject to refund. The issue of the justness and reasonableness of the rate was set for hearing. Petitioner, the Louisiana Public Service Commission, intervened in the hearing and participated as a party. At the conclusion of the hearing, the administrative law judge (ALJ) issued a decision approving the automatic adjustment clauses

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In contrast to Section 205, which governs newly filed rates, Section 206, 16 U.S.C. 824e, provides that the Commission may proceed to determine whether existing rates are unjust or unreasonable. If the Commission makes such a determination, it shall by order fix the just and reasonable rate for the future.

[2] Section 205(f)(4) of the Federal Power Act, 16 U.S.C. (Supp. V) 824d(f)(4), provides:

> [T]he term "automatic adjustment clause" means a provision of a rate schedule which provides for increases or decreases (or both), without prior hearing, in rates reflecting increases or decreases (or both) in costs incurred by an electric utility. Such term does not include any rate which takes effect subject to refund and subject to a later determination of the appropriate amount of such rate.

[3] The 1979 amendment also included a change in the rate of return on common equity.

but requiring Middle South to file annual reports on the costs of the system (see Pet. App. A-6).

On review, the Commission affirmed the ALJ's approval of the automatic clauses, but removed the requirement that Middle South file annual reports (Pet. App. A-2 to A-20).[4] The Commission gave several explanations for its approval of the automatic adjustment clauses. First, it noted (*id.* at A-8) that its consistent policy, as articulated in *Central Power & Light Co.*, 11 F.E.R.C. (CCH) ¶ 61,102 (May 2, 1980), has been to permit three types of automatic adjustment clauses without any attached review conditions: (1) fuel adjustment clauses; (2) full cost of service formula tariffs, particularly for unit sales to affiliates; and (3) interchange rates based upon incremental costs. The Commission found that the proposed amendment fit within the second category, since the transactions the amendment covered were unit sales and sales to affiliates; it held that such clauses were particularly appropriate for affiliates operating on a pooled basis. In addition, the Commission found the automatic adjustment clauses reasonable because they provided for downward, as well as upward, adjustments in cost. Finally, the Commission noted that all costs under the automatic formula would be subject to Commission audit, and to investigation (on the Commission's own motion or by complaint) under Section 206 of the Federal Power Act, 16 U.S.C. 824e. On this basis, the Commission concluded that the automatic clauses were just and reasonable (Pet. App. A-9).

3. On review, the court of appeals affirmed the Commission's decision (Pet. App. A-21 to A-33). The court found the Commission's decision supported by substantial evidence and concluded that the utility had demon-

[4] The Commission also established a rate of return on common equity. The Commission's determination on rate of return was affirmed by the court of appeals and is not challenged here.

strated good cause for using the automatic formula as the rate rather than having to comply with the notice provisions of Section 205(d) of the Federal Power Act, 16 U.S.C. (Supp. V) 824d(d), whenever it wished to reflect changes in costs among pool members (Pet. App. A-30).

ARGUMENT

The decision of the court of appeals, affirming the Commission's approval of automatic adjustment clauses, is fully in accord with settled legal principles, does not conflict with the decisions of this Court or other courts of appeals, and does not warrant further review.

1. It is well established that ratemaking is not "an exact science" (*FPC* v. *Conway Corp.*, 426 U.S. 271, 278 (1976)), but rather a process in which the expert ratemaking body has considerable latitude. See *Montana-Dakota Utilities Co.* v. *Northwestern Public Service Co.*, 341 U.S. 246, 251 (1951). "A presumption of validity therefore attaches to each exercise of the Commission's expertise, and those who would overturn the Commission's judgment undertake 'the heavy burden of making a convincing showing that it is invalid because it is unjust and unreasonable in its consequences.'" *Permian Basin Area Rate Cases*, 390 U.S. 747, 767 (1968).

In addition, the Commission's decisions must be upheld on review if supported by substantial evidence. See 16 U.S.C. 825*l*. As this Court has observed:

> [W]hether on the record as a whole there is substantial evidence to support agency findings is a question which Congress has placed in the keeping of the Courts of Appeals. This Court will intervene only in what ought to be the rare instance when the standard appears to have been misapprehended or grossly misapplied. *Universal Camera Corp.* v. *NLRB*, 340 U.S. 474, 491 (1951).

Mobil Oil Co. v. *FPC*, 417 U.S. 283, 310 (1974).

In this case, the court of appeals found (Pet. App. A-30) that the Commission's decision to approve the automatic adjustment clauses was supported by substantial evidence. There is no reason for this Court to disturb that finding.

2. Contrary to petitioner's claims (Pet. 12), approval of an automatic adjustment clause does not constitute "an abandonment of the regulatory process." As the Commission explained (Pet. App. A-9) and as the court of appeals noted (*id.* at A-30), the Commission, through its periodic audits, is capable of detecting any inappropriate costs that may be placed in the formula in the future. In addition, both the Commission and the court below emphasized that automatic adjustment is at all events subject to investigation pursuant to Section 206 of the Federal Power Act, 16 U.S.C. 824e.

The Commission's approval of an automatic adjustment clause is consistent with settled administrative practice and has received judicial approval. The automatic formula approved in this case is also known as a "cost of service tariff," because the formula encompasses all of the elements of a cost of service. Since 1946, the Commission consistently has approved cost of service tariffs in appropriate cases, primarily when the service involved sales to affiliates.[5] Although full cost of service tariffs have not been as widely employed for electric utilities under the Federal Power Act as for

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[5] See *Michigan Gas Storage Co.*, 5 F.P.C. 965 (1946); *Trunkline Gas Supply Co.*, 9 F.P.C. 721, 729 (1950); *American Louisiana Pipe Line Co.*, 16 F.P.C. 779 (1956), on rehearing, 18 F.P.C. 795 (1957); *Pacific Gas Transmission Co.*, 24 F.P.C. 134 (1960); *American Louisiana Pipe Line Co.*, 29 F.P.C. 932 (1963); *Michigan Gas Storage Co.*, 43 F.P.C. 625 (1970); *Maine Yankee Atomic Power Co.*, 52 F.P.C. 76 (1974).

natural gas pipelines under the Natural Gas Act,[6] the Commission has approved the use of automatic fuel adjustment clauses for all utilities.

The fuel adjustment clause, like the automatic cost of service tariff in this case, is a formula that operates as a filed rate. In both cases, the formula eliminates the need to provide the Commission with prior notice of changes in rates so long as those changes are computed in accordance with the formula. Courts that have reviewed Commission-approved fuel clauses have consistently concluded that the Commission has the authority to approve the automatic formula as the filed rate. See *Public Service Co.* v. *FERC*, 600 F.2d 944, 960 (D.C. Cir.), cert. denied, 444 U.S. 990 (1979); *Jersey Central Power & Light Co.* v. *FERC*, 589 F.2d 142 (3d Cir. 1978), cert. denied, 444 U.S. 880 (1979); *Virginia Electric & Power Co.* v. *FERC*, 580 F.2d 710 (4th Cir. 1978); *Maine Public Service Co.* v. *FPC*, 579 F.2d 659 (1st Cir. 1978). No court has suggested that the Commission's approval of a fuel adjustment formula as the rate is an abdication of regulatory responsibility.[7]

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[6] Several cost of service tariffs for electric utilities have been approved. See, *e.g.*, *Maine Yankee Atomic Power Co.*, 52 F.P.C. 76 (1974); *Central Power & Light Co.*, 11 F.E.R.C. (CCH) ¶ 61,102 (May 2, 1980). Because the pertinent provisions of the Federal Power Act and Natural Gas Act are virtually identical (compare 16 U.S.C. (& Supp. V) 824d and 824e with 15 U.S.C. 717c and 717d), the consistent approval over the years of cost of service tariffs under the Natural Gas Act is of obvious relevance to the validity of such tariffs under the Federal Power Act. See *Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571, 577 n.7 (1981); *Permian Basin Area Rate Cases*, 390 U.S. 747, 820-821 (1968); *FPC* v. *Sierra Pacific Power Co.*, 350 U.S. 348, 353 (1956).

[7] Petitioner mistakenly relies (Pet. 15-16) on two cases for the proposition that automatic adjustment clauses are against public policy. In *Sunray Oil Co.* v. *FPC*, 364 U.S. 137 (1960), the Court affirmed the Commission's refusal to approve a request for a certificate of public convenience and necessity for a limited term. In its analysis, the Court gave an example of a contract

3. Petitioner contends (Pet. 17) that, by amending Section 205 of the Federal Power Act to require the Commission to review periodically the operation of automatic adjustment clauses in rate schedules (16 U.S.C. (Supp. V) 824d(f),[8] Congress intended to permit the use of such clauses "only in the limited circumstances when this action is necessary because normal ratemaking is unworkable." This contention is without merit.

The court of appeals correctly explained that Congress did not intend by this amendment to limit the Commission's ability to approve automatic clauses as a general matter. The court first noted that, although Section 205(f) of the Power Act "specifies criteria to be used by [the Commission] in reviewing the use of automatic adjustment clauses, the statute does not state

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with an escalator clause (that is, a clause providing for increases but not decreases in rates) and said that any adjustment under that contract clause would be subject to the provisions of the Natural Gas Act that parallel Sections 205(d) and 205(e) of the Federal Power Act. The purpose of the Court's example was to point out that a contract term could not supersede the Commission's authority to investigate new rate filings under the Natural Gas Act, not that the Commission lacked the authority to approve such a clause. In *Episcopal Theological Seminary* v. *FPC*, 269 F.2d 228 (D.C. Cir. 1959), the court of appeals affirmed the application of the Commission's regulation that the operation of a clause in natural gas schedules providing for periodic rate increases (*i.e.*, an escalation clause) constituted a change in rates for which a rate filing was required. The court made clear that it agreed with the Commission's concern with escalator clauses in long term contracts because such clauses are not designed to match future rate increases with future costs to the gas company. *Id.* at 233-234. Here, however, the automatic clause approved for the Middle South System will track cost increases and decreases.

[8] This amendment was enacted as Section 208 of the Public Utility Regulatory Policies Act of 1978 ("PURPA"), Pub. L. No. 95-617, 92 Stat. 3142.

that the use of such clauses is restricted to unstable, unpredictable expenses" (Pet. App. A-28). In fact, the court observed (*ibid.*), in its 1978 amendment to Section 205 of the Power Act, "Congress specifically recognized [the Commission's] practice of authorizing an automatic adjustment formula to operate as a rate." The court pointed out (Pet. App. A-28) that the Conference Report accompanying the 1978 amendment states that "[t]he conferees do not indicate any preference for inclusion or exclusion of any item in an automatic adjustment clause." H.R. Rep. No. 95-1750, 95th Cong., 2d Sess. 96 (1978).

As the court of appeals' discussion clearly demonstrates, Congress, which was aware of the Commission's practice of permitting the use of automatic adjustment clauses, would almost certainly have amended Section 205 of the Power Act to restrict the Commission's authority to approve such clauses had their use been considered inconsistent with the purposes of the Power Act. Instead, Congress left it to the Commission to decide, in the exercise of its discretion, whether to allow a formula rate in a particular tariff and whether the formula may reflect some or all of the elements of the cost of service.[9]

4. The Commission found in this case that use of the cost of service formula will not produce excessive rates. Petitioner challenges that finding on substantial evidence grounds. Petitioner claims (Pet. 21): (1) that ac-

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[9] See FERC, *Automatic Adjustment Clauses In Public Utility Rate Schedules, A Staff Report on the Implementation of Section 208 of the Public Utility Regulatory Policies Act of 1978* (1982). In that report, the Commission's staff concluded: "The primary purpose of [cost of service formula] rates is to provide an equitable basis for types of inter-utility transactions that appear desirable to encourage * * *. [These] transactions tend to encourage coordination of plans for increases in capacity." *Id.* at 72.

cumulated deferred taxes were improperly included in Middle South's rate base in the past, and (2) that the approved clause improperly includes recovery of so-called nonrecurring expenses. Neither of these claims has merit.

First, the Commission expressly required Middle South to reduce the rate base by the amount of deferred taxes collected (Pet. App. A-19). The Commission took this action even though petitioner had waived its claim concerning deferred taxes by failing to raise the issue at the hearing before the ALJ (*ibid.*). As a result of this adjustment, the formula will properly reflect the cost of service effect of deferred taxes, now and in the future.

Second, the Commission affirmed the ALJ's determination that certain nonrecurring operating and maintenance expenses were appropriately included in the cost of service formula as just and reasonable costs. *Middle South Services, Inc.*, 13 F.E.R.C. (CCH) ¶ 63,032 at 65,112 (Nov. 13, 1980). As the ALJ, found (*ibid.*), inclusion of these expenses

> * * * is entirely consistent with, and required by cost of service tariffs. The object of such tariffs is to track costs more closely than is possible under a fixed rate tariff. Thus, increased expenses paid by the operating companies, such as those non-recurring expenses of the past, will be reflected in the charges. * * * [T]here has been no such showing or claim here by the Louisiana Commission that past non-recurring expenses were imprudent or improperly incurred.[10]

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[10] The ALJ's decision went on to state that the hearing and refund procedure specified in that decision will protect customers from imprudent costs in the future. On review, the Commission dropped the procedure established in the initial decision in favor of periodic audits and investigations under Section 206 of the Federal Power Act (Pet. App. A-9).

Thus, the record discloses that the formula, as approved by the Commission, reflects only those costs legitimately incurred by the Middle South System. As the Commission further explained (Pet. App. A-9), the formula tracks decreases as well as increases in the cost of service, thus removing the Commission's traditional objections to tariffs with only cost escalation clauses. See *South Carolina Generating Co.* v. *FPC*, 19 F.P.C. 855, 860-862 (1957).

5. Finally, petitioner contends (Pet. 11, 22-26) that the use of an automatic formula is particularly inappropriate in this case because "the impact of [the FERC decision] is felt by intrastate ratepayers." However, the impact on intrastate ratepayers here is not different from the impact of any other wholesale rate approved by the Commission. Every rate that the Commission establishes is, under the scheme of the Federal Power Act, a rate for wholesale (sale for resale) interstate service. See 16 U.S.C. (& Supp. V) 824. The wholesale purchaser in each case will pass through the wholesale rate to its retail customers. In this respect, ratepayers in Louisiana are no different from ratepayers in any other state whose utility purchases power from another utility to meet the demands of its customers.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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APPENDIX

1. Section 205(e) of the Federal Power Act, 16 U.S.C. 824d(e), provides:

> Whenever any such new schedule is filed the Commission shall have authority, either upon complaint or upon its own initiative without complaint, at once, and, if it so orders, without answer or formal pleading by the public utility, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the public utility affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of such five months, the proposed change of rate, charge, classification, or service shall go into effect at the end of such period, but in case of a proposed increased rate or charge, the Commission may by order require the interested public utility or public utilities to keep accurate account in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts are paid, and upon completion of the hearing and decision may by further order require such public utility or public utilities to refund, with interest, to the persons in whose behalf such amounts were paid, such portion of such increased rates or charges as by its decision shall be

found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the public utility, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible.

2. Section 206 of the Federal Power Act, 16 U.S.C. 824e, provides:

(a) Whenever the Commission, after a hearing had upon its own motion or upon complaint, shall find that any rate, charge, or classification, demanded, observed, charged, or collected by any public utility for any transmission or sale subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affected such rate, charge, or classification is unjust, unreasonable, unduly discriminatory or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order.

(b) The Commission upon its own motion, or upon the request of any State commission whenever it can do so without prejudice to the efficient and proper conduct of its affairs, may investigate and determine the cost of the production or transmission of electric energy by means of facilities under the jurisdiction of the Commission in cases where the Commission has no authority to establish a rate governing the sale of such energy.